BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2002-239-W/S - ORDER NO. 2002-866

DECEMBER 23, 2002

IN RE: Application of Harbor Island Utilities, Inc. for Approval of a New Schedule of Rates and Charges for Water and Sewer Service Provided to Residential and Commercial Customers in Harbor Island, Beaufort County, South Carolina.	)	ORDER APPROVING INCREASES IN RATES AND CHARGES

This matter comes before the Public Service Commission of South Carolina (the Commission) on the Application of Harbor Island Utilities, Inc. (Harbor Island or the Company) for approval of an increase in water and sewer rates for its residential and commercial customers on Harbor Island, in Beaufort County, South Carolina. The Company is presently providing 390 water and 354 sewer services to residential and commercial customers, and is presently operating under rates set by this Commission in Docket No. 97-262-W/S by Order No. 98-575.

Pursuant to the instructions of the Commission's Executive Director, the Company published a Notice of Filing, one time, in newspapers of general circulation in the Company's service area, and served a copy of said Notice on all affected customers in the service area. The Company furnished affidavits to show that it had complied with the instructions of the Executive Director. A Petition to Intervene was filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate).

Accordingly, a hearing was held on December 4, 2002 at 10:30 AM in the offices of the Commission. As per State law, a panel, consisting of Commissioners Mitchell, Carruth, and Atkins heard the case. Commissioner Mitchell acted as Chairman. Harbor Island was represented by J. Thomas Mikell, Esquire. The Company presented the testimony of Robert G. Gross and R. Arnold Ellison. The Consumer Advocate was represented by Charles M. Knight, Esquire. The Consumer Advocate did not present any witnesses. The Commission Staff (the Staff) was represented by F. David Butler, General Counsel. The Staff presented the testimony of Barbara J. Crawford and William O. Richardson.

Robert G. Gross, Owner and President of the Company testified. Gross noted that he acquired the Company in February, 2000. Further, through a contract, Gross' other company, The Beaufort Group, LLC, provides the administration, operation, and maintenance of the Company. Harbor Island purchases potable water from the Beaufort-Jasper Water and Sewer Authority (BJWSA) at a wholesale rate and sells it at a retail rate to customers on Harbor Island. The water that Harbor Island purchases from BJWSA comes from a water line installed and owned by the Fripp Island Public Service District (FIPSD). That line transports water from the end of the BJWSA line on St. Helena Island, across Harbor Island, and on to Fripp Island. Harbor Island Utilities pays a transportation fee to the FIPSD for the use of that line.

Additionally, according to Gross, Harbor Island Utilities collects and treats the sewage generated on Harbor Island. The treated effluent is pumped to Fripp Island, where it mixes with the treated effluent from the FIPSD prior to being disposed of on the local golf course.

Gross states that the rates at Harbor Island have not increased since 1998, while operational and maintenance costs have risen as the system continues to age. The transportation fee paid to FIPSD has risen each year for the past four years. Further, Harbor Island must relocate the force main that transports treated effluent to Fripp Island, since the bridge that the main is attached to is being rebuilt by the South Carolina Department of Transportation.

R. Arnold Ellison, a former owner of the Company, and presently a consultant, also testified. Ellison testified that for FY-00, the net revenue over expenses was ($10,356), while the net revenue over expenses for FY-01 was ($62,120). Further, Ellison noted that since the Company's last rate adjustment in 1998, BJWSA has raised its wholesale rate by 5.76%. FIPSD has also increased its transportation fee since the last rate increase by 20%.

Ellison stated that, in its Application, the Company is asking for an adjustment of the water base rate from $11.69 per month to $18.50 per month for a ¾ inch meter and an increase in the commodity rate from $3.50 per 1000 gallons used to $3.60 per 1000 gallons used. Other water rates would also increase for customers with larger size meters. These increases would provide an operating margin of 15.5%. Further, Harbor Island is asking for a sewer rate adjustment from $26.00 per month to $29.50. The increased sewer revenues would provide an operating margin of 16.5%. Further, Harbor Island is seeking an increase in its water and sewer tap fees.

With regard to the line relocation, Ellison noted that the cost for the required work will be approximately $70,000, thus the Company will have to seek a loan.

Barbara Crawford of the Commission's Audit Department testified on behalf of the Commission Staff. Mrs. Crawford proposed some twenty-four accounting and pro forma adjustments, some of which were concurred in by the Company. In the following paragraphs, we will discuss adjustments in which the Staff and the Company differ, for the most part, although there are several that we find necessary to discuss, even though the Company and the Staff agree on the adjustment. It should be noted that we are herein adopting all of Staff's adjustments, because of the reasoning as stated below.

First, both the Staff and the Company propose to annualize water and sewer revenues based on a bill frequency analysis for the year 2001. The Company and Staff adjusted water revenues by $24,375 and sewer revenues by $2,423. Next, both the Staff and Company propose to remove DHEC Recoupment Fees in the amount of ($1,614). The Department of Health and Environmental Control (DHEC) has jurisdiction over such fees. These fees are billed to the Company's customers as a separate line item on the utility bill and are intended to recover the cost of certain water testing functions required by State law. Both Staff and Company have eliminated revenues of ($1,614) and Staff has eliminated the associated expenses of ($1,614) from water operations. Staff' position should be adopted, since associated expenses should be eliminated when revenues are eliminated.

Although the Company proposed a reduction in revenue for late charges earned, the Staff rejected the adjustment, since late fees should be included in the calculation of the operating margin. Late fees are approved by this Commission. We agree with Staff in this instance that no reduction in revenue for late charges earned should be allowed, since the monies are included in calculation of the operating margin.

Both Staff and Company propose to remove tap fees in the amount of ($5,092) from revenues. However, Staff also proposes to remove an equal amount from expenses, since the cost of the tap is equal to the tap fee. This adjustment allocates ($3,310) to water operations and ($1,782) to sewer operations. We agree with Staff's position, since we believe that an equal amount of expenses should be removed when revenues are removed.

The Company proposes to amortize rate case expenses totaling $3,000 over three years. The Company proposes an adjustment in the amount of $1,000. Staff did not include this expense, since it was only an estimate. We agree with Staff, since the amount involved was not known and measurable.

Staff and the Company agree on adjustment for excess operating expenses, management fees, and labor charges, all involving use of the Beaufort Group, LLC. We find that these expenses and fees were shown to be reasonable. The Company testimony was that it was charged the going rate for the services provided by the Beaufort Group, LLC, and probably could not have obtained the services purchased in any less expensive manner. See Hilton Head Plantation Utilities, Inc. v. Public Service Commission of South Carolina, 312 S.C. 448, 441 SE2d 321 (1994), which holds that the Commission should ascertain the reasonability of charges arising out of inter company relationships between affiliated companies.

The Commission Staff proposes to annualize depreciation expense using year end plant in service. Plant in Service was reduced by contributed capital and contributions in aid of construction (tap fees) before depreciation expense was computed. The Staff proposes to reduce depreciation expense in the amount of ($2,675). Staff's adjustment allocates ($1,471) to water operations and ($1,204) to sewer operations. The Company does not propose an adjustment to annualize depreciation expense. However, the Company does propose to allocate depreciation expense in the amount of ($1,972) from the water operations to the sewer operations. We disagree with the Company and adopt Staff's adjustment. Staff's calculations correctly allocate depreciation expenses between water and sewer.

With regard to purchased water, an analysis of water purchases reflected that water had been lost in excess of 10%. Both Staff and Company propose to reduce purchased water expense by ($6,017) in order to adjust for the unaccounted for water. We adopt this adjustment for unaccounted for water in excess of 10%. An unaccounted for water rate of 10% is the lower end of the range for unaccounted for water according to the American Water Works Association Manual M32 (1989), of which we took judicial notice. Thus, non-allowance of unaccounted for water over 10% is reasonable, and based on the AWWA standard.

We would note in connection with the matter of unaccounted for water that the Company is required in accordance with DHEC Regulation 61.58.7 (of which we have also taken judicial notice) to initiate and carry out a program aimed at detecting leaks in the distribution system. Additionally, any leaks found through this program or any leaks discovered through other means must be repaired promptly. Further, DHEC Regulation 61.58.7 mandates that records be kept of the leaks detected and the repairs made. The Company is required by law to promptly handle water leaks; therefore, a lower percentage of unaccounted for water will result in a decreased cost of purchased water. Further, we hereby order the Company to submit the outcome of its water audit consistent with AWWA Manual M32 with its next application for a rate increase.

We would state that leak detection and repair has economic value in that detection of leaks and repair reduces water costs to the Company and ultimately the ratepayer. In addition, leak detection and repair has difficult-to-quantify benefits, such as a gain of information about the distribution system, reduced risk of contamination, and improved environmental quality.

As noted above, both Staff and Company proposed an adjustment to deal with unaccounted for water above the 10% level. We approved the adjustment, but as per the above-noted paragraph, we believe that appropriate leak detection and repair may improve the Company's percentage of unaccounted for water, and thus, save money for both the Company and its ratepayers.

It should be noted that the Company originally proposed an adjustment to expense the estimated debt service cost to relocate a pipeline across a new bridge which will be built at some time in the future as mentioned in the testimony of the Company's witnesses. The Staff does not propose to include this estimate, since the Commission does not recognize estimated costs, i.e. the costs are not known and measurable. Staff states a belief that the cost of debt should be based on embedded cost rates, capital structure, and rate base. The Company admitted on cross-examination that it should not seek coverage of this expense at this time. We agree with the Staff and reject the Company's original proposed adjustment in this instance.

The Staff computed income taxes on an as adjusted basis. Staff used water and sewer operating revenue less expenses to compute income tax expense. The income tax expense adjustment was $2,451 for water operations and $3,377 for sewer operations for a total of $5,828 for combined operations.

Lastly, the Company proposes to adjust purchased water expense to reflect customer growth. The Staff does not propose to make such an adjustment. The Staff computed growth in both revenue and expenses by applying a growth factor to net operating income. The customer growth adjustment is shown in Staff's Exhibit A-2. The global approach for customer growth appears to us to be better than the Company's approach in this instance; therefore, we reject the Company's adjustment.

William O. Richardson of the Commission's Utilities Department testified. Richardson noted, through testimony and exhibits, that the Company was seeking a 21.3% increase in water revenues, and a 13.4% increase in sewer revenues, for a combined increase in revenue of 18.1%. (Late-filed audit Exhibits show that this increase in revenues would present operating margins of 18.71% for water, and 19.91% for sewer, for a combined operating margin of 19.18 %.)

FINDINGS OF FACT

1. Harbor Island Utilities, Inc. is a water and sewer utility operating under the jurisdiction of the Commission, serving Harbor Island in Beaufort County, South Carolina.

2. The Company is seeking a rate increase in the water base rate from $11.69 per month to $18.50 per month for a ¾ inch meter and other increases in its basic facilities charges for its other sizes of meters. In addition, the Company seeks an increase in the water commodity rate from $3.50 per 1000 gallons used to $3.60 per 1000 gallons used. Further, Harbor Island is seeking a rate adjustment from $26.00 to $29.50 per month for sewer service. In addition, the Company is seeking increases in its water and sewer tap fees.

3. The system presently has 390 residential and commercial water customers and 354 residential and commercial sewer customers.

4. The Commission Staff's adjustments should be adopted in toto for the reasons stated in the testimony and exhibits of Staff witness Crawford as recited above.

5. The Company testimony supports the granting of a 15.5% operating margin for water operations and a 16.5% operating margin for sewer, which we adopt.

CONCLUSIONS OF LAW

1. The Company's operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. Section 58-5-10, et seq. (Supp. 2001).

2. The Commission concludes that each of Staff's adjustments proposed by the Commission Staff is appropriate and each is hereby adopted by the Commission, based on the reasoning as stated above.

3. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rate of a public utility. For a water utility whose rate base has been substantially reduced by customer donations, tap fees, contributions in aid to construction, and book value in excess of investment, the Commission may decide to use the "operating ratio," and/or "operating margin" method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the total operating income for return by the total operating revenues of the utility. The Commission concludes that the use of the operating margin is appropriate in this case.

4. The Commission is mindful of the need to balance the respective interests of the Company and of the consumer. It is incumbent upon this Commission to consider not only the revenue requirement of the Company, but also the proposed price for the water, the quality of service, and the effect of the proposed rates upon the consumers.

5. Based upon all of these considerations, the Commission determines that the Company should have the opportunity to earn a 15.5% operating margin for water operations and an operating margin of 16.5% for sewer operations, as requested by the Company. In order to have a reasonable opportunity to earn these operating margins, the

Company will need to produce $187,404 in total water operating revenues and $117,029 in total sewer operating revenues. These may be shown as follows:

TABLE A

WATER OPERATING MARGIN

Operating Revenues	$187,404
Operating Expenses	158,640
Net Operating Income	28,764
Customer Growth	288
Net Income for Return	29,052
Operating Margin	15.50%

TABLE B

SEWER OPERATING MARGIN

Operating Revenues	$117,029
Operating Expenses	97,718
Net Income for Return	19,311
Operating Margin	16.50%

6. The increase granted to the Company is a total of $30,325, consisting of $23,925 for water operations and $6,400 for sewer operations. This represents a reduction of $10,876 from the requested water increase and $8,468 from the requested sewer increase by the Company.

7. The three fundamental criteria of a sound rate structure have been characterized as follows:

> ...(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing objective under which the rates are designed to discourage the wasteful use of

> public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.
>
> Bonbright, Principles of Public Utility Rates, (1961), p. 292.

The Commission considered the proposed increase presented by the Company in light of the various standards to be observed and the interests represented before the Commission. The Commission has also considered the impact of the proposed increase on the ratepayers of the Company. The Commission must balance the interest of the Company-the opportunity to make a profit or earn a return on its investment, while providing adequate water and sewer service-with the competing interest of the ratepayers-to receive adequate service at a fair and reasonable rate. In balancing these competing interests, the Commission has determined that the proposed schedule of rates and charges is unjust and unreasonable and inappropriate for both the Company and its ratepayers.

Considering these principles, the Commission holds that the granted revenue requirements should be spread out among the Company's customers as follows. We grant a basic facilities charge for a ¾ inch meter of $16.12 per month, for a one inch meter of $18.00 per month, and for a one and one-half inch meter of $24.00 per month, all for residential water service. We grant the increase in the water commodity charge from $3.50 per thousand gallons to $3.60 per thousand gallons. We also grant such other increases in basic facilities charges for water as shown on Appendix A, which is attached hereto. These new basic facilities charges were derived from the reduction in water revenue that we granted. We also grant a sewer rate increase to $27.50 per month, also as shown on Appendix A, which is derived from our granted increase in revenue of $6,400 instead of the requested amount of $14,868 which was originally requested by the Company.

Further, we believe that the record in this case supports an increase in the water tap fee from $650 to $687 per tap. This is justified as per the Company's documented cost of installing water meters, and additionally, the fact that the Company pays Fripp Island $487 for each water tap fee collected. We also grant increases as shown in Appendix A on tap fees for other water meter sizes. We deny the requested increase in sewer tap fees, because we believe that the record in this case does not support such an increase. Other rates are approved as shown in Appendix A to this Order.

IT IS THEREFORE ORDERED THAT:

1. The proposed schedule of rates and charges as filed in the Company's Application is found to be unreasonable, and is hereby denied.

2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. The schedule is deemed filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2001).

3. The Company shall maintain its books and records in accordance with the NARUC Uniform System of Accounts as adopted by the Commission.

4. The Company shall notify each customer in each class of the customers' increase in rates with the first bill that includes the new increase in rates made subject to this Order.

5. If the approved schedule is not placed in effect within three (3) months after the date of this Order, the approved schedule shall not be charged without written permission of the Commission.

6. The Company shall file the outcome of its most current water audit at the time it files its next rate increase request.

7. This Order shall remain in full force and effect until further Order of the Commission

BY ORDER OF THE COMMISSION:

Mignon L. Clyburn, Chairman

ATTEST:

Gary E. Walsh, Executive Director

(SEAL)

HARBOR ISLAND UTILITIES, INC.
12-1B Fairfield Road
Lady's Island, SC 29907

APPENDIX A

FILED PURSUANT TO DOCKET NO. 2002-239-W/S – ORDER NO. 2002-866
EFFECTIVE DATE: DECEMBER 23, 2002

USER FEES – WATER

1. **Residential**

¾" meter	Base	$16.12/month
	Commodity	$3.60/1,000 gallons
1" meter	Base	$18.00/month
	Commodity	$3.60/1,000 gallons
1½" meter	Base	$24.00/month
	Commodity	$3.60/1,000 gallons

2. **Commercial Water Service**

¾" meter	Base	$21.75/month
	Commodity	$3.60/1,000 gallons
1" meter	Base	$24.25/month
	Commodity	$3.60/1,000 gallons
1½" meter	Base	$32.00/month
	Commodity	$3.60/1,000 gallons

3. **Landscape Irrigation**

¾" meter	Base	$16.12/month
	Commodity	$3.60/1,000 gallons
1" meter	Base	$18.00/month
	Commodity	$3.60/1,000 gallons
1½" meter	Base	$24.00/month
	Commodity	$3.60/1,000 gallons

4. **Meters Used for Multiple Residential Units**

Minimum monthly charge at $16.12/unit
Commodity charge of $3.60/1,000 gallons

FIRE HYDRANT USAGE

1.	Installation Charge	$ 50.00*
	Advance Payment	$ 50.00*
	Cost per 1,000 gallons	$ 3.60

RECONNECTION FEES

1.	Disconnect/Reconnect at Customer's Request	$ 50.00*
2.	Disconnect/Reconnect due to Nonpayment	$ 50.00*

TAP FEES

1.	Single Units	
	¾" meter	$ 687.00
	1" meter	$1,037.00
	1½" meter	$1,187.00
	2" meter	$2,187.00
2.	Master Meter for Multiple Units	
	1" – 2"	$ 687.00 per unit served
	Greater than 2"	$ 500.00 per unit plus cost of meter installation

ADVANCE PAYMENT

1.	For Water Used During Construction	$ 100.00* (paid with tap fees)

USER FEES – SEWER

1.	Residential	$ 27.50
2.	Commercial	$ 27.50 min. for 10,500 gallons $ 1.50 per 1,000 gal excess usage (Flow is determined by using DHEC wastewater unit load allocation)

TAP FEES – SEWER

Residential	$ 500.00*
Trailer Park	$ 250.00/pad*
Commercial: Water supplied through 1" – 1½" meter	$ 850.00*

* No change to previously approved rates